UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Credit Reforms in Organized Wholesale Electricity Markets	**Docket No.**	**AD21-6-000**

Impact of Market Design on Credit Risk
Opening Statement of Abram Klein
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Thank you for the opportunity to participate in this technical conference. My name is Abram Klein and I am Managing Partner of Appian Way Energy Partners, a financial marketer in US RTO markets. Appian Way trades financial transmission rights (FTRs), financial futures and work with customers to manage congestion risks. Prior to co-founding Appian Way in 2014, I was Head of Trading over 13 years for a large Independent Power Producer which involved managing a large diverse asset portfolio, serving load and proprietary trading. I have spoken and testified at the Commission on numerous occasions over the years on market design topics.

I would like to first acknowledge that the ISO/RTOs have done and continue to do an amazing job operating competitive electricity markets at least cost and with efficient transmission usage; facilitating non-discrimination and open access to transmission service; and most importantly, maintaining the reliability and security of the electricity grid. This is a big, complex and technical job, and has brought tremendous benefits to electricity consumers. The recent power outages brought about by the winter storms in Texas and Oklahoma serve as a reminder of what an essential service the electricity grid truly is. To all those working for and helping the ISOs serve the public interest – thank you!

From an overall market design framework, ISOs should adopt credit and counterparty risk management (CCRM) policies and processes that strike a balance between protecting the market from default on the one hand and not hindering beneficial competition, liquidity and open access on the other.

To this end, I have six main points I would like to share with you today.

First, as much as ISOs are expert at operating efficient markets and maintaining reliability, they must also be expert at CCRM. Each ISO will of course adopt its own specific CCRM to its own circumstances. CCRM need not be the same across ISOs, but there are certain basic principles and best practices. ISO policies are developed via a stakeholder process that involves compromise. FERC must not allow ISOs and their stakeholders to adopt substandard CCRM policies and practices. It should be unacceptable, for instance, for any ISO not to have variation margining when a customer's mark-to-market trading position moves into the red.

Moreover, it is likely that the ISOs and market participants would benefit from a common, standardized and streamlined KYC process that should involve inter-ISO cooperation.

Second – and fortunately -- CCRM can largely be achieved with implementation of best practice. This entails:

1. **Margining**, including:
    a. "Initial margin" to ensure a minimum level of position-based collateral for each customer proportional to the customer's trading activity; and
    b. "Variation margin" to fully collateralize net mark-to-market losses associated with a customer's trading positions
2. **Customer counterparty qualification** such as know-your-customer (KYC) protocols and minimum capitalization standards

Trillions of dollars of financial trading takes place daily in commercial markets worldwide and these markets operate within a well understood CCRM framework. CCRM practices such as margining are easily implemented and occur in the daily standard operations of all electricity market participants, whether they be investor-owned utilities, municipal utilities and public power, banks, independent power producers, trading firms, financial marketers, etc. There is no reason every ISO cannot do CCRM well.

Third, in terms of CCRM implementation, it is essential that each ISO have an appropriate cadre of internal staff and leadership with CCRM expertise and experience. The ISO's CCRM staff must first ensure that the ISO's CCRM policies represent best practice within the industry, and second ensure that such policies are implemented consistently on an ongoing basis. We believe it may be prudent for each ISO to hire independent experts periodically to audit their CCRM policy, capability, and implementation.

Fourth, with respect to FTRs, regular and periodic market pricing through balance-of-period auctions is essential for good CCRM. NYISO, PJM, MISO and ERCOT all have regular balance-of-period FTR auctions. These auctions offer important liquidity, price transparency and competition to the FTR market and allow these ISOs to regularly assess and revalue market participant FTR portfolios, allowing for more accurate margining and identification of exposures. Currently, SPP is considering implementing balance of period auctions as a credit policy reform. NE-ISO and CAISO do not have balance of period auctions. The Commission should consider making balance-of-period auctions mandatory; quarterly (like MISO) or even monthly (like PJM) auctions would be appropriate.

Fifth, the purpose of minimum capital requirements is to ensure the business suitability of entities seeking to trade with ISOs. Firms that have greater net worth are more likely to have the enterprise sophistication and financial wherewithal to pay their bills. But this basic gating mechanism should not be conflated with margining requirements. Minimum capital requirements are not intended to set aside additional collateral; that is the purpose of initial margin. As a case in point, a proposal from SPP would require financial entities trading TCRs (SPP vernacular for FTRs) to set aside $20 million in unencumbered funds, excluding holding collateral at other ISOs, to qualify for TCR activity. Such a policy exceeds the $10 million "Eligible Contract

Participant" (ECP) standard noted in FERC Order 741 and may represent an unnecessary and an anti-competitive barrier to entry. We view the $10 million ECP standard as sufficient.

Sixth, Appian Way is extremely skeptical regarding the viability of mandatory third-party clearing for FTRs. I want to clarify that this represents Appian Way's perspective and does not reflect the views of all Energy Trading Institute (ETI) members. We have no concern with voluntary third-party clearing if certain market participants would gain efficiencies from novating their FTR portfolios over to an exchange; for instance, if their futures positions that would offset their FTR portfolios. However, we believe mandatory third-party clearing may be too costly and raises significant legal hurdles. These concerns may be able to be addressed, but at minimum, there is a lot of woods to chop before mandatory third-party clearing can be considered a viable proposal.

Moreover, our paramount concern regarding third-party clearing of FTRs is that we do not believe it would be accessible to a substantial number of market participants who are critical to enhancing the competitiveness of the FTR market. Many legitimate market participants who currently trade FTRs safely and responsibly would be shut out of the market, in our opinion. We simply do not believe that exchange clearing members would be willing to clear the necessary 1) volume of FTR trading, 2) breadth of nodal locations and 3) extent of FTR market participants with whom they do not have established relationships. FTRs are not pork bellies or tiger shrimp. Each ISO may have many thousands of eligible points representing a deep qualitative change in the complexity of the power business for the clearing members. Clearing members, we think, are too far removed from this complex product to be comfortable taking on the scale of business that third-party clearing of FTRs would entail.

ISOs know their own markets and pricing fundamentals best and are best suited to operate and be counterparty to FTRs transactions. Indeed, because FTRs serve as the financial equivalent of firm transmission in LMP markets and are a critical component of competitive electricity markets, it is essential that ISOs operate the FTR markets to facilitate the market for congestion hedging. With proper CCRM policies, there is no reason ISOs cannot safely and responsibly maintain their present role of clearing the FTR market.

As a final point, I would like to note that while exchange clearing members or private companies can choose not to trade with any market participant for any reason, ISOs have an obligation to facilitate open access. Nevertheless, it is essential that ISOs prevent "fly-by-night" companies from amassing material amounts of market risk without commensurate risk to their firm of loss, as has occurred in case of the 2018 GreenHat and 2008 PowerEdge defaults in PJM. PJM's past flawed CCRM policies allowed "heads I win, tails you lose" trading strategies by certain market participants who were able to take big risks and double down on losses without any material amount of their own "skin in the game." We believe PJM has done a good job in responding to these challenges. The reforms implemented and proposed by PJM, while still a work in progress, put in place a strong CCRM policy regime.

With that, I look forward to hearing the other panelists and answering your questions.

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